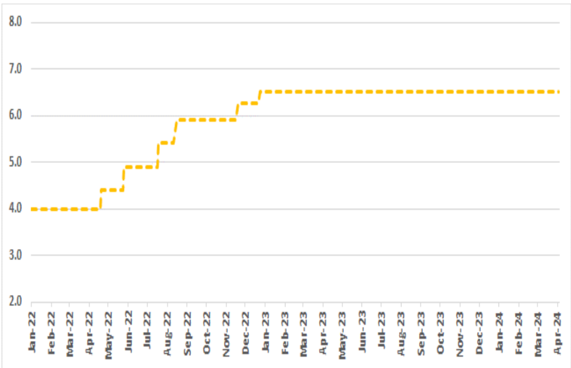
RBI holds policy rates unchanged, maintains focus on inflation and growth

- Mr. Sampath Reddy, Chief Investment Officer, Bajaj Allianz Life

In its first monetary policy for FY25, the RBI's Monetary Policy Committee (MPC) for the 7th consecutive time kept the policy rates unchanged, by keeping repo rate steady at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. The MPC also decided by a majority of 5 out of 6 members to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth. The MPC last raised the repo rate by 25 bps to 6.50% in its Feb 2023 meeting.

Repo Rate Trend (in %)



10 Year G-Sec Yield (in %)

Source: Jefferies, RBI, Bloomberg

On the inflation front, for FY25, RBI has retained its inflation projection at 4.5%, however it has revised its inflation forecast for quarterly projections. For Q1, inflation is projected at 4.9% (5% in Jan'24 policy), Q2 at 3.8% (4% earlier), Q3 at 4.6% (unchanged from last policy) and Q4 at 4.5% (4.7% earlier). The downward revisions by the central bank is primarily on account of record rabi wheat production which is anticipated to curb price rise and expectation of normal monsoon this year bodes well for the agriculture sector. Post the reduction in LPG prices, there is the possibility of fuel deflation. However, despite the cut in petrol and diesel prices in mid-March, the recent uptick in crude oil prices needs to be closely monitored. Given the volatility in financial markets and geo-political tensions pose upside risk to commodity prices and supply chains.

On the growth front, post the second advance estimates by NSO that expects the economy to register 7.6% growth in FY24, RBI has retained its growth projection for FY25 at 7%. The central bank governor highlighted that the strong GDP growth is projected in FY25 is based on upturn in the private capex cycle becoming steadily broad-based, persisting and robust government capital expenditure; healthy balance sheets of banks and corporates; rising capacity utilization and strengthening business optimism. However, prolonged geopolitical tensions and increasing disruptions in trade routes, pose risks to the outlook.

Outlook:

The policy was largely along expected lines. The Monetary Policy Committee (MPC) acknowledged the resilience of domestic economic activity, supported by investment momentum, positive business sentiment, and rising consumer confidence. The RBI remains extremely focused on ensuring the return of headline inflation to the medium-term target of 4%. With comfort on the growth front and the

Governor's acknowledgement of the last-mile challenge to disinflation, we believe RBI to maintain status quo on the repo rate through 1HFY25 and that pushes back the rate cut to 2HFY25.

They recognized the disruptive impact of recurring food price shocks on the disinflation process driven by moderating core inflation (ex-food & energy). Geopolitical tensions, their implications on supply chains, volatility in global financial markets and commodity prices pose significant upside risks to inflation. RBI's commitment to aligning inflation with the 4% target (+/- 2%) remains intact. The governor again reiterated that the Central Bank is focused on bringing inflation back to 4% level on a durable basis. The 10-year bond yield remained flattish post the policy announcement as the policy was in line with the market expectations.